THE

GEORGE WASHINGTON UNIVERSITY

NAVY GRADUATE COMPTROLLERSHIP PROGRAM

BUDGETARY ADMINISTRATION AND CONTROL FACILITATES INTELLIGENT MANAGEMENT

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For

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PREFACE

The eminent business historian, N. S. B. Gras, in tracing the evolution of business said, "In most of man's history there has been no business. In fact, business is such a late-comer that whole groups of men have never become adjusted to it."[1]

Until the turn of the century the businessman was much less scientific in his approach to management problems than he is today. Accounting, statistics, budgetary control, scientific organization and employee training are management adaptions of post-World War I. The widespread growth of collegiate schools of business has similarly been experienced during the same period of time. Only a superficial examination of business failures as reported by Dun and Bradstreet over the first century of their operations reveals a need for a wider application of scientific management in business operations.

This study of Budgetary Administration and Control is not a compendium on the techniques of preparation and operation of a budget, but rather a brief treatise on the history of the budget as an administrative and management device, including a broad analysis of the advantages and limitations in its use.

Charles H. Walker

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May, 1956

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[1]N. S. B. Gras, Business and Capitalism (New York: F. S. Crofts and Co., 1946), p. 27.

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CHAPTER I

BACKGROUND AND DEVELOPMENT OF BUDGETS

> No other management device of similar complexity has ever been accepted so quickly and installed so rapidly in American business as the budget.[1]

Definition of the Term.--Definitions of a budget are as numerous as published materials; however, the general concept running throughout the literature is well expressed in the ideas which follow. Gladstone said that the budget was not merely an affair of arithmetic but in a thousand ways was the root of prosperity of individuals, the relation of classes, and the strength of kingdoms.[2]

The Metropolitan Life Insurance Company, in its pamphlet, "The Budget as an Aid to Management," defines the budget thus:

> A budget system has been defined as a systematic method of gathering information from the past and present, of formulating plans for the future on the basis of it, and of reporting subsequently how these plans have been carried out. The application and use of this method of planning and recording give what is called 'Budgetary Control'.[3]

Another definition of the budget by Mr. John R. Bartizal places more emphasis on effective results in operation as contrasted with the previous idea which emphasized the mechanical aspects of preparation. He said, "A budget is

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[1]Prior Sinclair, Budgeting (New York: The Ronald Press Co., 1931), p. 3.

[2]The Metropolitan Life Insurance Company, The Budget as an Aid To Management, A Report Prepared by the Policyholder Service Bureau, (New York: The Metropolitan Life Insurance Co., Revised 1951), p. 5.

[3]Ibid.

CHAPTER I

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a forecast, in detail, of the results of an officially recognized program of operation based on the highest reasonable expectations of operating efficiency. What may be the 'highest reasonable expectations of operating efficiency' is a matter of management policy, but a forecast should not be regarded as a budget unless it is concerned with the correction of conditions which result in preventable waste or excessive costs."[4]

With respect to the financial aspects of budgeting it has been defined as "a financial plan summarizing the financial experience of the past, stating a current plan, and projecting it over a specific period if time in the future."[5]

Early Development.--In Order to develop the history of the budget in chronological sequence, consideration is given first to its use in controlling expenditures in government. Such a consideration will also explain how the initial use of the budget by business was patterned after governmental budgeting.

The term "budget" was first used in France between 1802 and 1803 by the French Government with reference to estimates of receipts and expenditures. It also had early usage in England as a term for describing the great leather bag which for a long time contained the documents presented to parliament to explain the wants and resources of the country. Other European countries subsequently adopted the budget as a control device.[6]

The English people slowly but eventually perfected budgetary procedure with the result that early in the nineteenth century it became an effective

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[4]John R. Bartizal, Budget Principles and Procedure (New York: Prentice Hall, Inc., 1942), p. 1.

[5]Marshall E. and Gladys O. Dimock, Public Administration (New York: Rinehart & Co. Inc., 1953), p. 194-195.

[6]"Budgeting Techniques," Journal of Statistical Society, XXIX (Royal Statistical Society, London: 1954), p. 325.

[illegible]

means for holding public officials strictly accountable. Their disbursements were limited to budgeted appropriations, and all their incomes were properly accounted for by an annual audit.

The English budget was intended to provide a more effective accounting for incomes and outgoes. Putting it another way, budgetary procedure was adopted with the idea of making accounting control more effective.

Moreover, two of the three parts of the English budget took the form of an accounting statement, namely the formal report of past expenditures and the estimated expenditures of the future. The budget was prepared by the financial officer in charge of the national accounts, the Chancellor of the Exchequer.[7]

It was not until 1895 that leaders in the movement for better municipal government in the United States decided that, instead of working through investigations and prosecutions, they could obtain the desired results more quickly and surely by first improving the structural organization and business procedure of the municipalities. Accordingly, bureaus of municipal research were established in the larger cities to provide the necessary specialized and technical assistance. They were supported by large taxpayers and other public spirited citizens and served as the contact and constructive agencies of the citizenry. Chambers of Commerce, also, in some instances added departments that took on similar duties. Some city governments were forced to meet public opinion by establishing research or efficiency bureaus as official staff units.

The efforts to reorganize municipal governments so as to centralize responsibility early led to the adoption of budget systems through which ex-

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[7]Edwin L. Theiss, "The Beginnings of Business Budgeting," The Accountants Digest, III (March, 1938), pp. 283-84.

penditures would not only be brought under responsible control but also be kept within the limits of estimated revenues. New York was a leader in improving the municipal budget methods, with Philadelphia, Boston, Chicago, and a socre of other large cities following closely. A national association of municipal comptrollers and accounting officers was organized and gave impetus to the movement. The adoption of commission and city manager types of government by medium-sized cities also helped, since budget systems aided such new governments to give additional and more efficient service at less cost. As a result of these changes, within a few years the financial methods of American cities were greatly improved.[8]

The adoption of municipal budgeting throughout the country naturally led to a demand for state budgets that found effective voice in the press of the country. The budget problems of the states were more difficult of solution than those of the municipal governments, mainly because authority and responsibility were not as well centralized. Although some of the constitutions required the governor to present at the beginning of each regular session of the legislature estimates of the amount of money to be raised by taxation, these provisions had not been construed as requiring the governor to submit a budget and in fact were complied with only in part.

By this time considerable literature on public budgets was available, and the proposal of state budgets was supported by a large and growing body of the electorate. The adoption of a budget system was made a chief issue in some state elections and legislatures took up the subject vigorously. Edwin L. Theiss writes, "that from 1911 to 1919 forty-four states enacted budget

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[8]National Industrial Conference Board, Inc., Budgetary Control in Manufacturing Industry, (1931), p. 4.

laws."[9] California and Wisconsin made some provisions for budget financing in 1911. Since that time every state in the United States has enacted some form of budgetary legislation.[10]

The War Chest organization of the World War I furnished the immediate impetus for widespread systematic financing and budgeting in social agencies. Since that time, budgetary control in private social agencies has been practiced in varying degrees as influence has been exerted by the community chest, community trust, other organizations, and individuals.[11]

The budget was first adopted in the United States as a governmental planning device. In 1912 President Taft appointed a commission to inquire into the general feasibility of the plan; however the National Budget Act was not finally passed until 1921. This Act required the President to present to Congress at the beginning of each year a complete budget of proposed federal expenditures and incomes. These estimates are discussed by the Congress and when finally approved, the appropriations become authorizations by law and to this extent must remain unchanged for the coming year.

The primary objective of most business enterprises is the securing of a profit and the accumulation of wealth. Because of this fact, budgeting has to a great extent, appropriated this same profit motive as its primary objective. The basic idea in budgeting is to conserve and increase the capital of a business. Budgeting aides management in realizing its profit objective by providing a scientific technique for forecasting business operations and

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[9]Theiss, op. cit., p. 283.

[10]A. E. Buck, Public Budgeting (New York: Harper & Co., 1929), pp. 14-15.

[11]A. W. Proctor and A. A. Shuck, The Financing of Social Work (Chicago: A. W. Shaw & Co., 1926), pp. 88-89.

establishing standards.

Opinion varies as to when the budget made its advent into American business; however, it seems to be generally agreed that it had made little progress prior to 1920. Since the disastrous deflation period of the early 1920's, private corporations have given widespread consideration to the use of the budget as a device for planning and control.

Frederick W. Taylor was the first person to conceive that management could be preplanned on the basis of predetermined costs and formulated into an operating program comparable to drawings and specifications for construction. Prior to his time the general belief was that managers were born, not made. Conditions have, however, changed since then. Taylor's concept of scientific management now dominates the industry. Out of it modern industrial forecasting, planning, cost accounting, and budgeting have developed. Modern business owes much to the concept of scientific management developed by Mr. Taylor. He was the pioneer in the application of the scientific method to the establishment of production standards and these sound methods of standardization are an essential tool for effective budgetary control.

Since 1920 budgeting has grown rapidly and substantially in the United States. This rapid growth can be accounted for by the fact that during this recent period a number of influential factors have been at work to produce conditions that were favorable for budgetary development.

Some of these factors came from within individual businesses, while others arose from sources separate and apart from individual business enterprises. Edwin L. Theiss lists the following as being the most important factors:

" 1. Industrial expansion and competition.
2. Open-mindedness of business executives.

3. Production standardization by industrial engineers.
4. Coordination of all business functions by management engineers.
5. Emphasis on internal trends and cyclical movements by statisticians.
6. Establishment of financial accounting control and development of standard costs, by accountants.
7. Endorsement of business budgeting by banks, credit men, and insurance companies.
8. Exchange of ideas through trade associations.
9. Training in educational institutions.
10. Production of budgetary literature."[12]

Since 1920 the adoption by business of the budget idea, in whole or in part, has been so extensive that today there are few lines of business in which one can not find at least some companies using budgets.[13]

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[12]Theiss, op. cit., p. 284.

[13]John H. MacDonald, Practical Budget Procedure (New York: Prentice Hall, Inc., 1946), p. 3.

CHAPTER II

REQUISITES FOR EFFECTIVE BUDGETING

Cardinal Principles.--Effective budgeting is recognized as an art, but even the talented artist must follow certain scientific rules and procedures in order to produce creditable work. Obedience to fundamental principles is equally important in attaining desirable budget objectives. An executive well versed in budgetary control would not claim that the budget is a panacea for all business ills. He would regard it as a planning and directive device used to gain coordination and to produce satisfactory operating conditions.

There are many factors that need to be considered to have an adequate system of budgetary control. The following factors are considered to be essential for an effective budgetary control system.

1. There should be a single executive responsible for directing the budget.
2. A definite organization should be established to assist the budget director in the administration of the budget. This organization would usually take the form of a budget committee composed of from three to seven senior department heads.
3. Complete accounting, statistical records, and reports should be maintained so that adequate information would be available for budgetary administration.
4. There should be a clear expression of operating objectives or policies by the president or general manager and the board of directors. Then it would be the task of the departmental heads to formulate a financial plan to execute the policies.
5. Budget estimates should be prepared by organization units in order to establish definite responsibility for operating results.
6. Budget estimates should be prepared within the framework of policies by those responsible for performance. Thus, coordination and motivation of planning and execution could be achieved.
7. Budgetary procedure should be sufficiently rigid to provide for definite control of the activities of the organization but at the same time flexible enough to allow for unforeseen conditions.
8. Regular and systematic comparison should be made between the items

CHAPTER II

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[illegible]—Although [illegible] is recognized as [illegible] was [illegible] extremely [illegible] prior [illegible] [illegible] extent [illegible] used. [illegible] [illegible] [illegible] equally important [illegible] [illegible]. [illegible] small [illegible] [illegible] [illegible]

of the budget estimates and the items of the recorded operations. Proper adjustments could then be made to improve the over-all operations.

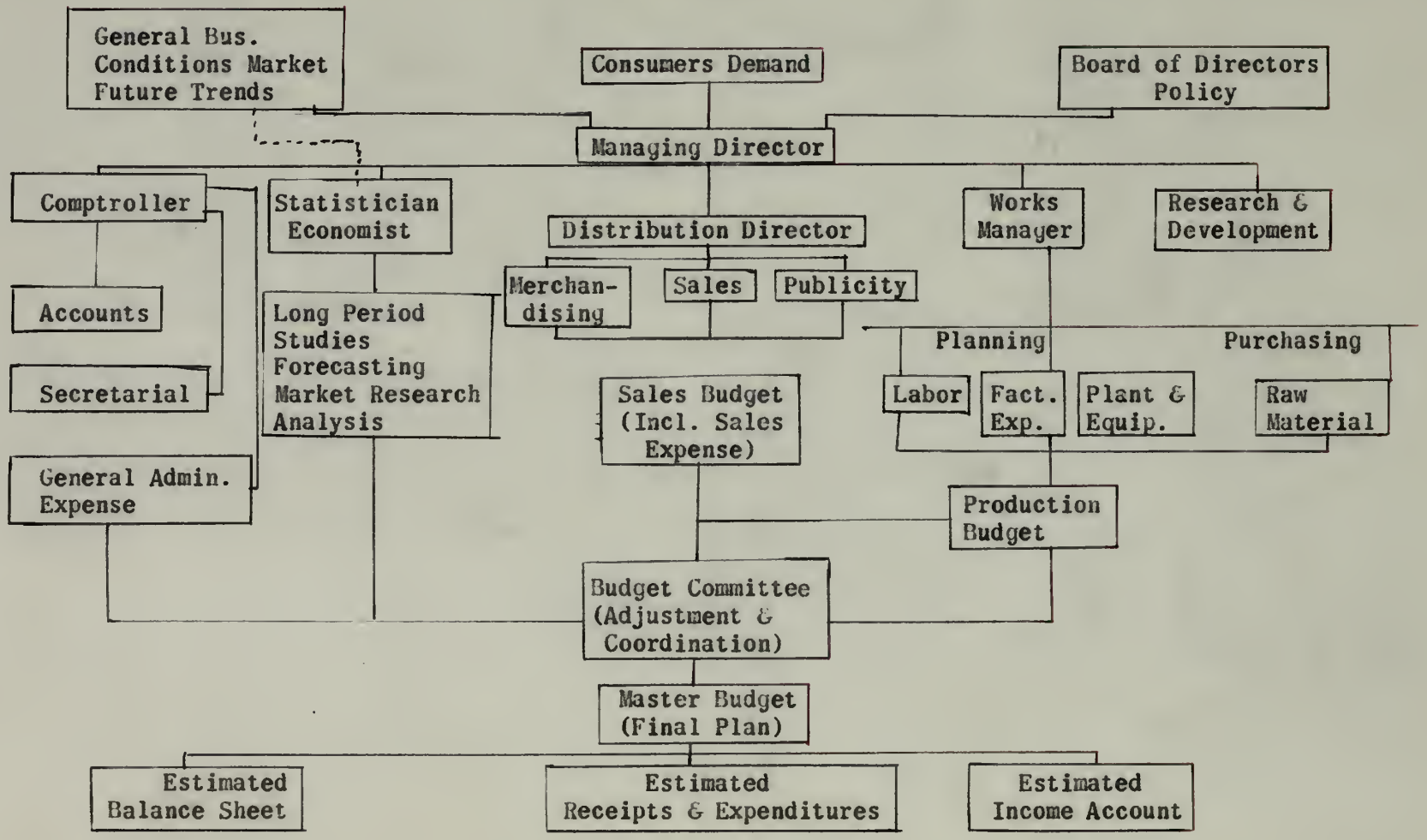
Budget executives should have an understanding of the factors mentioned above in order to be able to work out the more detailed questions of budgetary procedure. The following ten important budgetary questions are presented with a view to suggesting methods of treatment:

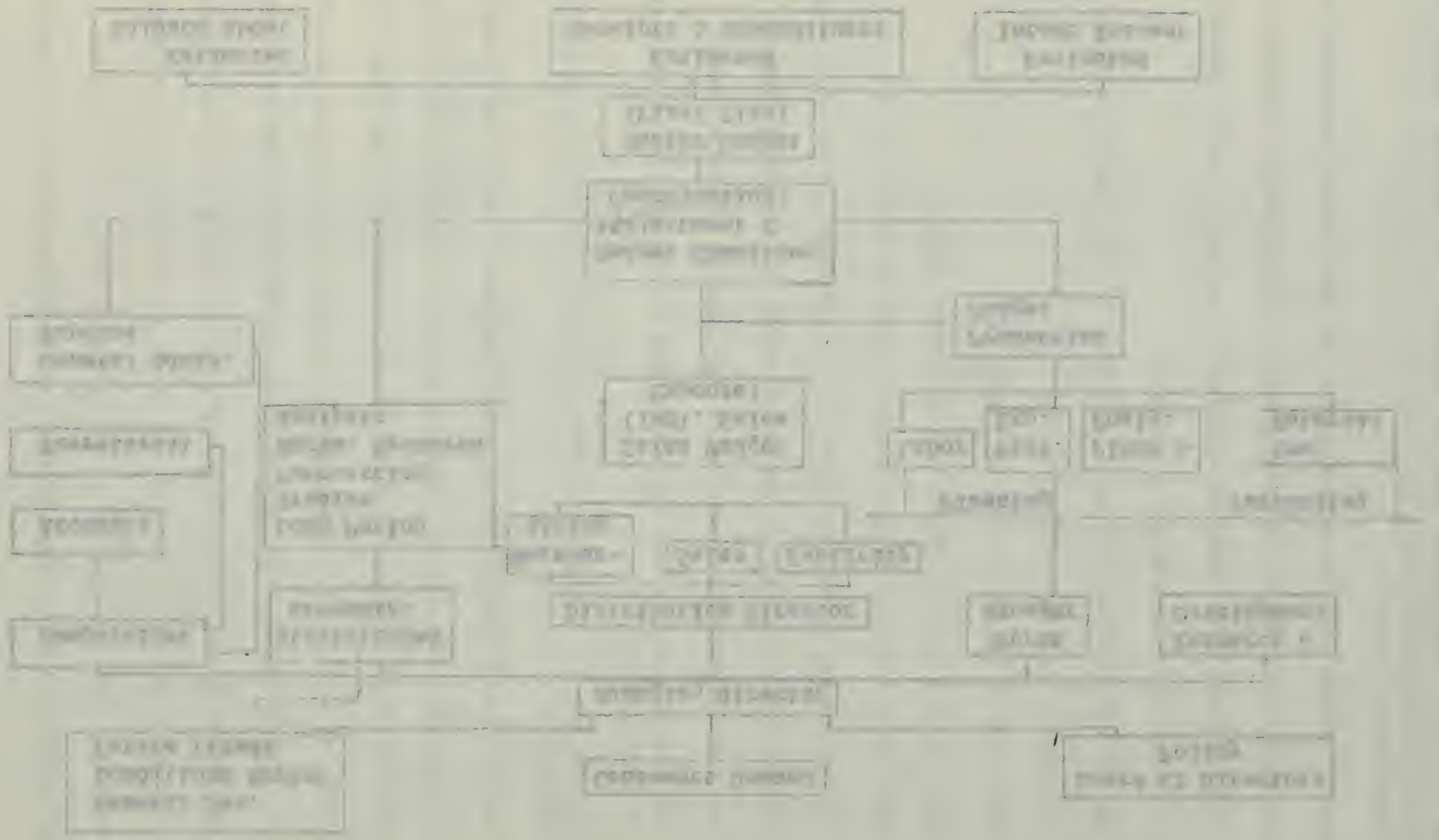
1. Who should be the executive in charge of the budget program?
2. Who should prepare estimates?
3. When should the estimates be prepared?
4. What should be the length of the budget period?
5. What should be the nature of the budget-estimate forms?
6. How much time should be spent in the preparation of budget data?
7. Who should bring the estimates together in a master budget?
8. Who should revise the estimates and finally approve them?
9. Who should enforce the estimates and to what extent should there be flexibility?
10. What means and procedures should be used in enforcing approved estimates?

Director of Budget Determined by Organization.--Usually the budget organization plan would need to be adjusted after the initial period of operation. Each situation will be influenced by such factors as the size of the organization and the number of operating divisions; the difference in training, duties, titles, and attitudes of the executive personnel. There are, however, a number of considerations fundamental to any situation regardless of the size or nature of the organization. On page 10 an organization chart and functional layout for budgetary control typical of modern practice is illustrated. This organizational chart and functional layout for budgetary control is not to

Figure 1

ORGANIZATION CHART AND FUNCTIONAL LAYOUT FOR BUDGETARY CONTROL





be considered to be that of any particular company but should be viewed as this writer's concept of a typical one that might be used in any large company.

An early decision should be reached on the question of whether the budget is to be operated under a centralized or decentralized organization. John H. Williams writes, "Experience indicates that authority and responsibility . . . except in matters of policy, accounting, budgeting, research, and standardization should be decentralized."[1] The budget is the instrument for stating and synchronizing the policies of administration in financial language. Centralization prompts economy of time and cost of preparation, uniformity in assembling and reviewing estimates and the accumulation of pertinent information which could be used during each subsequent period.

Assume that budgetary administration is centralized but not dominated by one person, then what form should centralization take; and what executives should be members of the central committee? More challenge is provided where the executives responsible for executing policies are given a part in budget planning. Mr. James L. Pierce writes, "Planning is a company-wide process of integration, in which no man can stand alone. All depend upon each other."[2] Usually in a large company the participating executives for budgetary administration would include the president, controller, sales manager, procurement manager and the financial manager. It is emphasized though, that many companies use other top management executives than those listed here and some occupy the same functions but are given different titles. Necessarily such a planning group should have a chairman of sufficient prestige and authority to get

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[1]John H. Williams, The Flexible Budget (New York: McGraw-Hill, Inc., 1934), p. 26.

[2]James L. Pierce, "The Planning and Control Concept," The Controller, XXII (September, 1954), p. 405.

results. As a general rule the controller in most companies occupys this position. This position of Budget Director would need the full support of the chief executive.

Mr. W. S. Clithero, Director of Budgets for Armour and Company says, "in the last analysis no one else but the chief executive of the company can be responsible for the budgetary program; because of itself, it represents the company's future policies and plans."[3] The Budget Director would be responsible for (1) designing a system of accounts sufficiently adequate for effectively portraying the operating conditions; (2) designing forms for assembling budget information; (3) designing reports for reporting and interpreting operations; (4) outlining general procedure for preparation, review, approval, and enforcement of the budget. There is, at present, a lack of uniformity in the title of the person holding his position. A budgetary title survey of ninety-three companies conducted by the National Industrial Conference Board gave twenty-one titles in use ranging from president to factory accountant. The titles were distributed as follows: president 7, treasurer 24, controller 27, assistant treasurer 5, and no other title numbered more than 4.[4]

The Budgetary Control in Manufacturing Industry study sums up the qualifications of the budget officer to be common sense, good judgment, leadership, the faculty of teaching other men, and familiarity with the administrative and operating problems.[5]

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[3]W. S. Clithero, "Organization for Budgetary Control," Annual Convention Series No. 51 (New York: American Management Association, 1926), p. 35.

[4]National Industrial Conference Board, Inc., op. cit., p. 38.

[5]Ibid.

The Budget Director of Combustion Engineering Corporation, Mr. C. H. Eckelkamp, stated that "A budget executive, in addition to coordinating facts and figures, must be cognizant of human relations and capable of coordinating viewpoints of many individuals making up management, establishing proper lines of communication between the various departments, selling the principles of budgeting and keeping them sold."[6] Mr. W. S. Clithero states that in his opinion and experience the controller or one with similar duties should be the supervisor of budgets.[7] The same opinion is shared by J. O. McKinsey[8] and M. V. Hayes.[9]

Who Should Prepare Estimates.--If this question were submitted to a large number of commercial or industrial organizations, the answers would indicate an absence of uniformity. J. O. McKinsey states a sound point of view when he says,

> "As a general rule, better results will be obtained if the individuals responsible for the performance of the estimate are the ones who originate it:
>
> 1. Because these individuals should be best able to make the estimates.
> 2. Because they will obtain most value from making it.
> 3. Because if they are required to make the estimate, they will feel more responsible for its enforcement."[10]

Dr. W. A. Paton, the distinguished accountant authority of the University of Michigan, has the following to say concerning budget estimates:

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[6]C. H. Eckelkamp, An Address before the Navy Graduate Comptrollership Students at George Washington University, February 13, 1956.

[7]Clithero, op. cit., p. 35.

[8]J. O. McKinsey, Managerial Accounting (Chicago: University of Chicago Press Company, 1932), p. 113.

[9]M. V. Hayes, Accounting for Executive Control (New York: Harper and Brothers, 1929), p. 47.

[10]J. O. McKinsey, Budgetary Control, (New York: ; The Ronald Press, 1922), p. 34.

> The budget estimates are usually prepared by departmental heads or those responsible for the execution of the budget. After the estimates are prepared they are assembled and combined into a balanced program of operations for the several departments. This combination and revision of estimates is usually done by the budget making authority. After the plan has been formulated it is essential that estimated revenue be compared with estimated expenditures, and if estimated expenditures exceed revenues, it may be necessary either to reduce the departmental expenses or to find means of obtaining additional funds.[11]

When Should Estimates Be Prepared?--The time of preparation cannot be determined arbitrarily; for there are a number of factors to be considered such as fiscal year or accounting period, scope and difficulty of preparation, and risk and uncertainty in the industry. It should be axiomatic, however, that the budget estimates should be prepared far enough in advance of the beginning of a new operating period to give adequate time for study, revision, approval and adoption, as well as time to inform the executives and to make necessary changes in personnel and equipment.

Length of Budget Period.--Each organization should determine, if possible, what period of time best serves its needs. Operating plans can be fairly definite for a quarter in advance and tentatively determined a year in advance for most businesses. A program of capital expenditures, however, can and should be developed for a five-year period, with tentative plans even beyond that time. Mr. J. O. McKinsey says, "The usual length of the budget period is for three, six, or twelve months."[12] A study made by the National Industrial Conference Board of New York revealed that 99 companies out of 162 used the twelve month period. Other companies used periods of six, four,

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[11] W. A. Paton et al., Accountant's Handbook (New York: Ronald Press 1952), p. 1206.

[12] McKinsey, op. cit., p. 37.

three, two, and one months.[13] None of these periods were used by more than eleven companies. "The American Telephone and Telegraph Company forecasts revenues and expenditures for a period of five years; the Woolworth Company makes yearly estimates and subdivides the yearly estimates into quarters."[14] Mr. W. F. Woodbury, Controller of Wobel Company, states, "In some instances companies have broken it down to a daily basis and they follow their budgets, their expense budgets, especially, every twenty-four hours."[15]

The length of the period will depend on such factors as seasonal requirements, means of financing, fiscal period, general economic conditions, and adequacy of information concerning past periods. To a certain extent business plans must be based upon expected general conditions over which a concern has no control; hence, they should be made only so far ahead as it is possible to reasonably predict such conditions. There will be no general rule as to the length of time as the nature of the business will regulate it to a large degree. The budget must keep before the organization the definite objectives of the business, and it must be made far enough in advance that uncertainty is eliminated as to the extent of immediate operations. Usually the operating plans can be fairly definite for a quarter in advance and tentatively determined a year in advance.

Many businesses today have shifted over to the continuous type of budgeting as opposed to a periodic program of budgeting. J. Brooks Heckert writes,

If definite plans can be made one quarter in advance, they may be revised

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[13] National Indistrial Conference Board, Inc., op. cit., p. 4.

[14] Paton, loc. cit.

[15] W. F. Woodbury, "The Budget Plan," Annual Convention Series: No. 51 (American Management Ass'n., New York 1926), p. 19.

> monthly, progressively dropping and adding a month, thereby always keeping a three months' program ahead. If a tentative program can be made for one year, this may also be revised monthly or quarterly by the same progressive procedure. This is particularly advantageous in a seasonal business. As one month ends, plans can be laid for the corresponding month one year hence while seasonal conditions are fresh in the minds of the executives and subordinates. A further advantage of continuous budgeting is that it keeps the problems constantly before the organization with a continuous process of examination and revision.[16]

Mr. Wayne T. Keller, Controller, Armstrong Cork Corporation, stated, "From the experience of different types of business it would appear that the budget period would be shortened when the hazard is great and lengthened as the business hazard decreases."[17] Mr. McKinsey concludes his discussion on the length of the budget period by saying that the following two things should be accomplished by the budget program:

> (1). That the executives obtain a perspective of the plans of the business for a sufficient length of time in advance to enable them to adjust their plans to the general program without too much abruptness. This is especially important in a rapidly growing business or one subject to material changes.
>
> (2). That the executives have a definite and concrete program for the immediate future which they can use as the basis of day-to-day operations. Such a program is also necessary as a basis of comparing the actual with the estimated performance, and unless this comparison is made it is impossible to exercise an effective control of the budgeting program. Such a definite and concrete program can usually be made for only a short time in advance.[18]

It is this writer's opinion that the length of the budget period should be either a calendar year or the length of the operating cycle for a particular business.

Forms for Budget Estimates and Time Spent in Preparation.--The well-

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[16]J. Brooks Heckert, Business Budgeting and Control (New York: The Ronald Press Co., 1946), p. 18.

[17]Wayne T. Keller, An Address before the Navy Graduate Comptrollership Students at George Washington University, March , 1956.

[18]McKinsey, op. cit., p. 35.

known budget authority, A. E. Buck, in his treatise on Public Budgeting, takes the position that standard forms are practically indispensable; for they simplify the task of translating the department budgets into a master form. They insure uniformity in the presentation of budget information and in details according to a uniform classification.[19] William E. Thomas writes, "It is usually the duty of the budget director, under the supervision of the controller, to design the forms on which estimates are accumulated and to establish a calendar for submitting department estimates."[20]

A timely warning is given in Budgetary Control in Manufacturing Industry in stating that forms should be simple and designed for the information that actually will be needed. Unless care is exercised, much time of clerks and others may be wasted in gathering and compiling unnecessary data and entering it on the forms.[21]

The Budget Director should make continuing efforts to encourage the adoption of companywide budget forms. Getting estimates on standard forms facilitates standardization of methods, machines, and procedures and thus reduces clerical costs. Greater usage of standard forms also permits procuring them in larger quantities and so reduces printing costs.

It should be self-evident that budget forms should be devised for particular companies. It is impossible for anyone, no matter how much experience he may have gained, to design any methods, forms, or procedures that will be adaptable to the needs of all companies.

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[19]Buck, op. cit., p. 230.

[20]William E. Thomas, "Budgeting For Profit," (University of Illinois Bulletin No. 407, Urbana, Illinois, October 1955), p. 9.

[21]National Industrial Conference Board, op. cit., p. 50.

Mr. N. F. Woodbury summarized his discussion on the question of time devoted to budget preparation as follows:

(1). The time will depend on the efficiency and class of people preparing the budget.

(2). On statistics available for preparation.

(3). On the stage reached in the process.

He concluded by giving his opinion that most business concerns will need sixty days.[22]

Consolidating Estimates.--The preliminary budget plan is based upon estimates made by the department heads themselves, working with the accounting department and cost department and coordinated with the budget director. After these estimates have been made and reviewed by the budget executive, it is then necessary to bring such estimates together in a Master-Budget Form. Usually this function will be delegated to the official in primary charge of budget preparation. At this stage this procedure is essential so that the composite picture of estimated revenues may be compared with estimated expenditures.

Review and Approval of Estimates.--Estimates which have been submitted by departments and assembled in a master form are carefully reviewed by the budget committee and, after revision, are transmitted to the board of directors or its committee. The usual budgetary review procedure in the case of a company operating a budget system through a budget committee is as follows:

(1). The budget officer coordinates and adjusts the various estimates prepared by the operating and expense departments of their operations for the budget period.

(2). The budget committee considers these estimates and makes any necessary adjustments.

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[22]Woodbury, op. cit., p. 19.

(3). The budget officer incorporates these revisions in the estimates for submission to the managing director for approval.

(4). After the budget has been approved by the management, the budget officer advises the individual department heads of their budget quota for the period, and provides any explanations that may be desirable to indicate the reason for any changes compared with the original estimates.

(5). The budget officer keeps both the operating departments and the budget committee advised of the actual progress of current results in relationship to the budget estimates, and makes any investigations that may be necessary towards discovering and correcting the cause of discrepancies. Toward this end the budget officer usually maintains a series of charts showing budget realization in graphic form.

(6). As and when necessary, the budget committee revises the budget in accordance with radical changes in underlying conditions.[23]

The board of directors, or a committee assigned by them, should always study the estimates and make or propose necessary changes. Mr. M. V. Hayes in discussing the Director's approval of the budget says,

> The directors are in the last analysis the ones that set the goal for business. The budget which is presented to the directors may be revised before it is approved by them. If the results which are forecast do not meet with their approval, they must be revised and the proper administrative and executive action provided to secure the desired results. When the directors approve the budget, the tentative budget should be brought into agreement with it. The chief executive with each major and minor executive then has his goal. Executive action should be provided in order to carry out the budget.[24]

By way of summary it may be said that the directors should approve the budget because it affords an opportunity for them to study and to suggest changes in estimates set up by operating executives, and it further affords an opportunity to place final approval on definite plans which may serve as a goal for measuring the effectiveness of operations.

The Budget Manual.--A budgetary control program which has as one of its objectives the careful planning of all activities is not complete unless the procedure for the development of budgets is also closely planned. To be

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[23]A. W. Willsmore, Business Budgets and Budgetary Control (London: Sir Isaac Pitman & Sons, Ltd., 1949), p. 19.

[24]Hayes, op. cit., p. 197.

efficient budgeting should be a cooperative undertaking involving all key personnel. To coordinate their individual efforts it is important that the procedure for budgeting be reduced to writing in the form of a budget manual. While each budget manual is designed to meet the particular needs of the company for which it is prepared, some matters included in almost any manual are:

1. Objectives of the budget plan.
2. Organization through which it functions.
3. Duties and responsibilities of the budget committee, budget director, department heads, and others responsible for the preparation and administration of the budgets.
4. Length of the budget period.
5. Procedure for the approval and revision of budgets.
6. Due dates for budget estimates and reports.
7. Procedure for enforcing the budget.[25]

One distinguished observer has summarized the benefits of such a manual as follows:

> The use of a budget manual furnishes an extremely helpful guide in both introduction and maintenance of a budget program. Authority and responsibility for the preparation and administration of the budget are clearly stated. The manual defines the duty and authority of each individual and committee as members of the budget organization and is a place of reference on budget procedure. It insures the preparation of each budget in a uniform manner. It assists the organization in coordinating its plans and activities. Finally, a budget manual sells the advantages of budgetary control to the organization as a whole, particularly to those executives who are personally responsible for budget preparation and execution.[26]

A well prepared budget manual will contain the chart of accounts devised to facilitate the collection of accounting data. With reference to budgetary control, this data should be grouped in accordance with fields of responsibility as shown by the organization chart. If it is not so arranged

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[25]Theodore Lang, Cost Accountants' Handbook (New York: The Ronald Press Co., 1944), p. 1237.

[26]MacDonald, op. cit., p. 271.

steps should be taken to accomplish this. Failure to make the necessary changes in the chart of accounts often means continuing extra expense to produce the figures needed for comparison. This is often one of the last things considered by executives installing a budget program, and thus they frequently become concerned about the cost of budgeting.

Budget Enforcement.--"After approval it is necessary for the various departments to adjust themselves to the program and to account for performance.[27] This is the real test of successful management, for no plan is valuable unless it is effectively carried out.

At this point it is pertinent to differentiate between administration and enforcement of the budget. By administration is usually meant the collection of budget estimates, the preparation of the necessary statistics therewith, the correlation of accounting figures with budget figures, and preparation of comparative forms showing actual and estimated or budget amounts. Enforcement on the other hand, has to do with making the final decision in cases where a request for revision of the budget is made or where expenditures in excess of budget amounts have already been incurred.

The procedure of enforcing the budget should not be iron-clad. Estimates are set in the light of conditions as of the time of preparation. Though it is not best to follow an iron-clad procedure, a definite system will accomplish much better results than an indifferent haphazard plan. It should be clearly understood by all that the budget is merely a guide and not a dictator. Usually the controller or budget director is in a rather pivotal position for enforcing estimates. His responsibility is to compare actual performance with estimates, to prepare reports showing the relationship, and

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[27]Paton, loc. cit.

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to analyze the variations and point out the causes for significant variations. It is not within the realm of the controllers function to take operating people to task for exceeding the budget. One recognized authority has observed,

> His correct course is to report the situation to responsible operating management and, if he sees fit, to the president, using the same figures and terms in each case. The problem then rests with the president and his operating subordinates, which is exactly where it belongs. It should be discussed and action determined in the direct line organization.[28]

Any one of several or a combination of procedures may be followed in controlling the budget-appropriation expenditures. One means of control is to pre-approve each expenditure requisition before the expenditure is authorized. This method requires a verification of the budget-appropriation balance against the proposed expenditure. If the appropriated balance is not sufficient to cover the proposed expenditure then it would be necessary to refuse the approval, or if possible to reduce the expenditure to the amount of the balance or to transfer an amount from another appropriation or a reserve appropriation in order to provide for the deficiency. The willingness to exceed the amount authorized would depend on the importance and size of the item and the policy and authority for shifting appropriations. Usually the budget director could make adjustments within certain authorized limits. If the amount exceeded the designated authorized limit it would be necessary to secure approval from the budget committee or board of directors.

Another method of enforcing estimates is to make the department head accountable for operating within the approved allocation. Under this plan, periodic, usually monthly, reports would be prepared to show in separate

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[28]James L. Pierce, "Budgets and People - A Positive Approach." A paper presented to the Finance Conference of the American Management Association at New York, November 20, 1953, pp. 15-16.

columns the following information: (1) amount of the "Budget Estimate," (2) amount of "Actual Expenditure," (3) the variation between estimate and actual amount identified as "Over or Under the Estimate," (4) amount "Budgeted for Year," (5) "Expenditures to Date," and (6) "Budget Balance."

The chief budget executive would be responsible for placing a copy of the periodic-budget report in the possession of each member of the budget committee. The information would serve as a basis for making a careful study of each item in order to determine actual operating results as compared to the estimates. The budget committee would give attention to any item which gave evidence of exceeding the appropriation. Decisions concerning variations from the estimates would be made and action taken within the authority of the budget committee or the board of directors.

In some departments a large part of the estimate would be consumed during the first few months of the budget period. For instance, the item of insurance could be contracted under a one, three, or five-year plan. Such items as salaries, wages, and food would be more uniform each month.

CHAPTER III

FORECASTING BUDGET ESTIMATES

"Business men are gradually emerging from the retrospective to the prospective attitude."[1]

Problem of Dual Nature.--The problem of budgetary organization and procedure is relatively uniform as compared to the problem of forecasting estimates. No formula has been derived by which a budget director can determine what the aggregate budget or the specific amount of each of the departmental estimates should be. In forecasting the amounts one is attempting to predict what may be expected in the way of income and to make provisions to coordinate the expenditures with income. Regardless of the particular avenue of approach used to determine budget estimates, the two general factors of internal and external conditions must be considered.

Internal Factors.--The internal factor of forecasting will be particularly influenced by past operations. If adequate accounting reports are available there will be little difficulty in determining the amount and nature of previous sources of income and expenditures. This is usually accomplished by having the accounting department prepare a statement of application of funds which summarizes the flow of working capital through the business. In their excellent study of the subject, W. E. Karrenbrock and H. Simmons point out the usefulness of this statement by noting "The application of funds statement

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[1]G. Charter Harrison, cited by J. E. Spinsoa Cattela in Efficient Business Management Through Budgeting and Budgetary Control (London: Mac Donald & Evans., 1948), p. 16.

CHAPTER III

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adopts a broader scope than that provided by the statement of cash receipts and disbursements. The latter statement shows the movement of cash through the business, summarizing the sources of cash receipts and the nature of cash disbursements."[2]

A second important internal factor relates to change in procedures and policies. Where major policy changes are to be inaugurated, the information of the past will be less important than where no policy changes are proposed. For example, in most concerns it may be assumed that management is at the very least desirous of keeping abreast of the normal growth of the industry, but, if its leaders are particularly progressive, they will endeavor to push beyond this point. This will necessitate plans to expand operations. These changes must be reflected in the budget and should give a warning to be cautious and a cue to go forward.

External Factors.--The irregularity or fluctation of production, sales, expense or profit items are subject to several components of a time series which may be classified as these: (1) growth or trend, (2) rhythms, and (3) irregular factors. The growth or trend is the long-time tendency for a business or industry to increase or decrease its sales and procurements volume, other activities, profits, and assets. The trend tendency may also prevail in prices, interest rates, national debt, age, population or any one of a hundred sets of data.

> The rhythms, distinct from growth components, are the movements in a time series which tend to repeat themselves or follow a common pattern over a period of years. Every industry and business is affected in varying degrees by the business cycle or cyclical rhythm.[3]

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[2]W. E. Karrenbrock and H. Simons, Intermediate Accounting (New York: South-Western Publishing Company, 1949), p. 477.

[3]M. A. Brumbaugh and L. B. Kellog, Business Statistics (Chicago: Richard D. Irwin, Inc., 1947), p. 542.

A business cycle consists of the irregular, difficult-to-predict fluctuations in sales, production, prices, employment, and other indices of business activity. In a time-series chart, the activity line above the normal trend line is usually recognized as prosperity while the activity below the normal line is called recession. There has been a wide range of variation in both the amplitude and length of the prosperity and recession periods which have taken place in recent economic history.

Seasonal rhythms provide another significant symptom. In this respect, Mr. J. E. S. Cattela has written, "The knowledge of this seasonal influence is not only important for an insight into the trend, but seasonal influence also affects the financial problems of the business."[4] This seasonal rhythm is the variation over the duration of a year which is usually related to recurring weather conditions. Construction normally is higher during a dry, warm period and lower during cold and inclement weather. Seasonal variations in business activity may also become evident because of observing social customs, such as special celebrations or observances of holidays. The Christmas and Easter seasons, for example, create an increased business volume for department stores and florist shops. There are also daily and weekly rhythms. An example of daily rhythm is reflected by data which shows the hourly consumption of electric power. The weekly flow of funds into and out of a Federal Reserve bank illustrates weekly rhythm.

Irregular or erratic movements in a time-series conform less to a pattern of occurrence than do trend, seasonal, or cyclical influences. The more serious causes of the indeterminate erratic force are war, weather, strikes, and other unusual disasters. The dislocation may produce a pendulum-like swing in business activity which may be local, national or possibly even

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[4]Cattela, op. cit., p. 22.

international in scope.

Forecasting Services.--Many companies have been successful in discovering a pattern of published general business conditions which correlates with the trend of their own activities. The views of many students of the subject are reflected by Riggleman and Frisbee who noted,

> These services are very valuable to the small business concern, since it cannot afford to carry on extensive research work, and must do without such analyses unless it can secure them from outside sources. And they are of even greater value to the large organization which has its own statistical department to interpret and apply the services' reports to its specific line of business.[5]

The forecasting services available are too numerous to list but in general could be classified as follows: (1) those which cover business conditions in a particular industry such as Iron Age which gives a weekly index of steel production and Printers' Ink which gives monthly figures on advertising expenditures; (2) those dealing with forecasting general business conditions. A limited list of such services includes Babson, Brookmire, Standard and Poors Statistics Company; (3) those which specialize on current and probable future activities in the area of Federal Government policies. Here one finds such publications as Kiplinger's Washington Letter, Whaley-Easton Service, and the Washington News Letter for Manufacturers. In judging the merits of these and other services, the reader should appreciate that forecasting work must not be rated on the basis of successful predictions alone, for there may be a considerable amount of guessing correctly by accident, the significance of an indicator may vary, and personnel may change. Consequently, in selecting an economic or statistical service, it is important to observe whether or not the methods that are used are fundamentally sound.

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[5] J. R. Riggleman and I. N. Frisbee, Business Statistics (New York: McGraw-Hill Book Co., 1951), p. 379.

Sales Forecast.--Preliminary to a forecast of sales it is necessary for management to determine the outlook for international, national and local economic conditions and to arrive at a tenable external position as it relates to the concern under consideration. The budget committee then is fortified to study internal conditions and to formulate and state policies concerning the next operating period. Any change in policy of expansion or contraction would be tempered and influenced by: (1) past performance, (2) national and local business outlook, (3) procurement limitations, (4) selling limitations, and (5) financing limitations.

The sales forecast usually constitutes the foundation of the entire business program and must be formulated before the production, purchasing and financial plans can be developed.[6] The importance of the sales forecast cannot be overemphasized. As figure 2 page 29 shows, all activities of the company are related to sales.

Many practical difficulties are encountered in preparing the sales forecast because general business conditions and multiple competitive factors are beyond the control of management, as are the whims, fancies and preferences of former and prospective customers. Nevertheless, some companies estimate sales within two or three percent of actual operating results. This is affirmed by many of the guest speakers that addressed the 1955-56 Navy Graduate Comptrollership Class. Mr. H. M. Francher, an accountant with the National Automobile Dealers Association, in a monograph "Get Your Profits First," gives the following illustrations of the sales estimate approach:

Using the case of a dealer doing $500,000 in new car volume, Mr. Francher first proposed the following budget;

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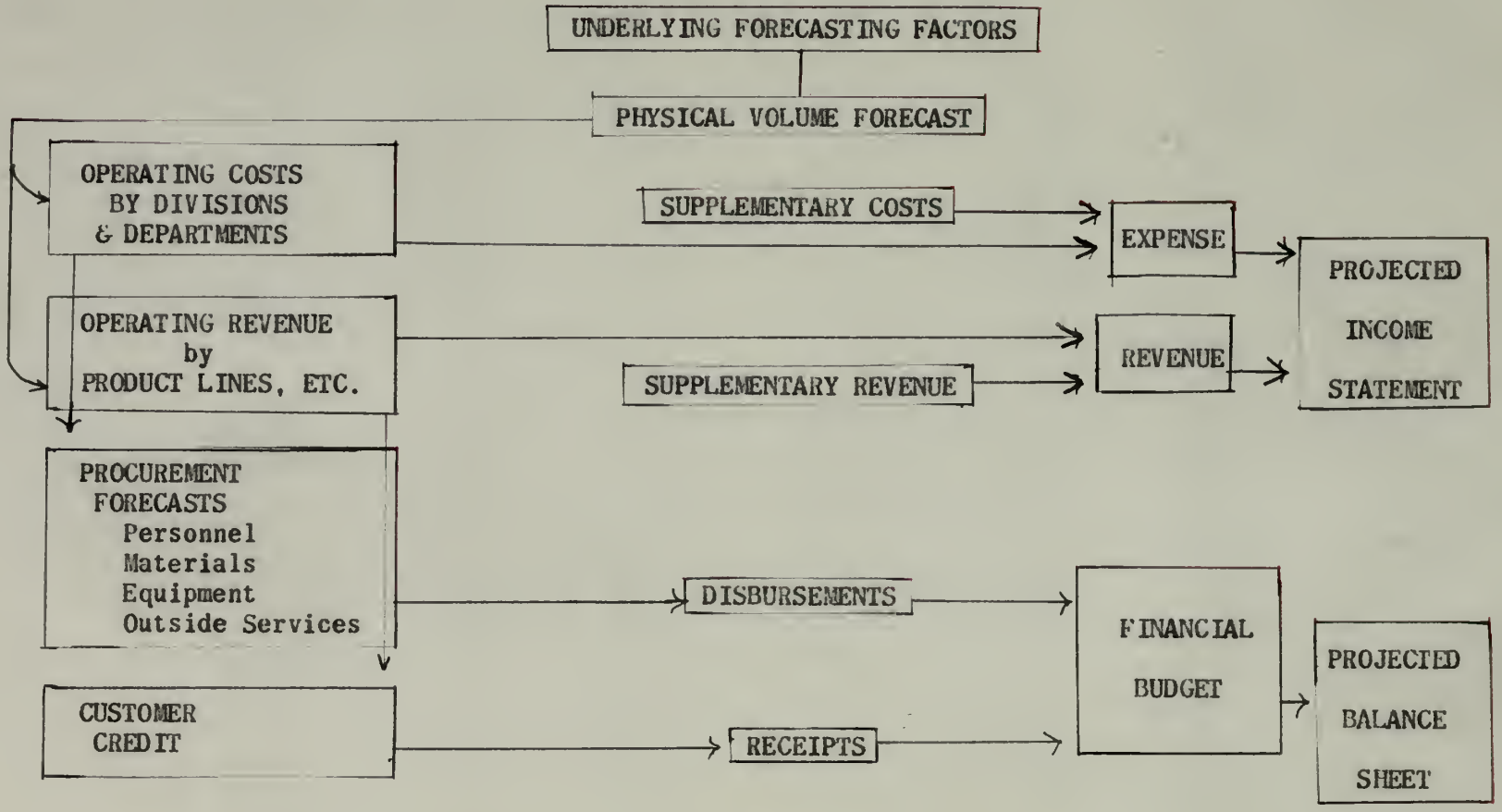
[6]Heckert, op. cit., p. 81.

Figure 2

RELATIONSHIP OF ALL COMPANY ACTIVITIES TO SALES FORECAST



New Cars	$500,000
Used Cars	125,000
Parts and Accessories	100,000
Labor	75,000
Total	$800,000

The next step is to figure net profit on that volume and set it aside first, so that the management will be sure of withholding that amount from the budget of expense. In this case it amounts to five percent of $800,000 or $40,000 net profit. The final step is to plan the operations so as to make these two goals attainable.[7]

The sales estimates should be prepared under the direction of the chief sales executive with the assistance of the department managers and individual salesmen. In a national organization the divisions would also include territories, customers, and commodities or products. The divisional estimates would be consolidated in a single master-sales estimate preliminary to the preparation of the master budget. In addition, the sales division would be responsible for preparing by organization units the advertising expense, sales expense, travel and communication expense, office expense and other selling expense items. Commenting on the sales budget one author observed,

> In order to ensure the working of the sales budget it will, however, not only be necessary to fix the total budget, but this budget has to be subdivided according to districts, article groups, or both, if necessary. Which subdivision will be chosen will depend entirely upon the organization of the sales department. The ruling principle must--for every budget, one and only one responsible man.[8]

In forecasting sales, the net effect of all changes must be evaluated. These include changes in product, customers, territories, channels of distribution, price lists, and sales promotion. Each decision the sales manager

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[7]H. M. Francher, "Get Your Profits First," Budgeting For Automobile Dealers (New York: Policyholders Service Bureau, Metropolitan Life Insurance Co., 1951), p. 6.

[8]Cattela, op. cit., p. 26.

makes with respect to sales policies and methods is accompanied by a forecast of the effect of that decision on sales volume and net profits. While the sales department is best able to judge the effect of the new policies and methods on sales volume, the budget director and controller are better qualified to interpret their effect on costs and final results. Accordingly, all important changes in sales plans must be reported to the budget director and the budget committee. The final decision on the probable effect of policy changes rest with the budget committee.

Procurement Forecast.--The simple arithmetic of procurement could be expressed as follows: inventory balances for the period plus sales (at cost) minus beginning inventory equals inventory procurement budget for the period. The answer, of course, is not one of simple arithmetic as this is an oversimplification of the problem. The procurement problem in any type of business involves a timely and economical coordination of sales and procurement. In a non-manufacturing concern the procurement problem is one of securing saleable merchandise in quantities, qualities and style at economical prices so as to satisfy maximum sales demands. In a retail business such as a department store, the coordination of sales and purchases is of such importance that the sales and procurement directors are usually under one departmental manager. Each of the departmental managers is responsible for the operation of his department within an investment allocated by top administration. Since careful planning is of the utmost importance, each department manager, with the assistance of his ranking associates, should prepare his merchandise estimates by: commodities, brands, quantities, prices, sizes, and time periods. For master-budget purposes the periodic amounts are the significant items of information.

The procurement problem in a manufacturing industry will be somewhat different from the retail business in that raw material must be purchased and converted into a saleable product. Here raw material purchasing is more closely related to production than to selling but there must be a well-coordinated plan to effect a balanced situation between procurement and sales. There are many factors that can complicate this desired coordination. John H. MacDonald lists six such factors.

(1). Monthly material requirements for production may not represent economically sized buying lots.
(2). Extremely favorable prices may be secured through long term contract.
(3). Some materials may have intrinsic properties which make it desirable to secure a season's supply while it is available.
(4). There may be a lapse of several months because of long time production processes.
(5). Materials may be available seasonally while production is fairly regular.
(6). Materials may be of foreign origin, in which case their supply and cost is influenced by the economic status of the country in which they originate.[9]

The director of purchasing in many manufacturing concerns reports directly to the production vice-president. The procurement budget would be prepared by the head of procurement and his associates. The significant items of information would include: commodities, prices, quantities, place, and month.

The procurement budget estimates in addition to material or merchandise purchase, should include actually stated estimates of finished goods under the following headings: Months Opening Inventory, Production, Shipments, Closing Inventory, Supplies, Service and Labor which are under the administration of other departments would normally not be included in the procurement budget.

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[9]MacDonald, op. cit., p. 134.

Payroll Budget.--The payroll budget may be included as a part of each departmental budget or it may be presented as a Consolidated Payroll Budget under headings as follows: Month, Direct Manufacturing, Indirect Sales, Administrative, Total. The payroll budget estimates should usually be prepared and included under the departmental head who is responsible for the operation of the department.

Cash Budget.--In discussing the importance of the cash budget, Joseph M. Landow writes,

> A cash budget is the most effective tool to aid planning for the cash requirements and resources of a business. It is an inclusive forecast of cash income and outgo and of estimated cash balances for a future period. Its primary purpose is to utilize existing and anticipated cash resources to finance operations, pay debts as they mature, pay for expansion considered desirable, and maintain a satisfactory liquid position.[10]

An accurate estimate of cash by each of the twelve months of the year is very important. In order to arrive at the satisfactory estimate a cash receipt and disbursements analysis is prepared for each department and then a consolidated report made from the several reports. In the routine operations of a business cash receipts are usually derived from cash sales of merchandise or service and receivables. Cash received through the sale of securities or other non-operating assets are included under non-operating income in the cash income estimates. Cash is disbursed in settlement of payrolls, merchandise purchased, rentals, insurance, other services, and vouchers and notes payable.

Care should be observed so that non-cash items of income and expense will not be included as a part of the totals. Cash disbursed for capital expenditures or to liquidate liabilities should be included, but bad debt or

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[10]Joseph M. Landow, "Financial Planning," Financial Handbook, ed. by Jules I. Bogen (New York: Prentice Hall, 1952), p. 676.

depreciation expenses which are non-cash items should be excluded.

Budgeted Profit and Loss.--Following the completion of the departmental and master budget, the profit and loss statement, for the budget period under review, is prepared in order to bring into focus the complete operating plan. "In drawing up the profit and loss budgets, the following component budgets are taken into account: sales in terms of selling prices and production costs, distribution costs, administrative expenses, research expenses and other operating expenditure and income."[11]

At the close of each month's operations, a comparative monthly profit and loss statement is prepared in order to compare the proposed monthly budget with the actual operating result. A third column provides for the variation of "over or under" from the budget proposal.

Budgeted Balance Sheet.--Budgetary plans may stop with the comparative profit and loss statement or an additional projection of an estimated balance sheet may be included for control purposes. Since comparisons afford an opportunity for constructive criticism, there is considerable value in the estimated balance sheet. Many well-managed companies also prepare a monthly comparative balance sheet. A typical three column statement would show the "budget estimate," "actual amounts," and "increases or decreases" as variations from the budget items.

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[11]The Organization for European Economic Co-operation, Cost Accounting and Productivity, A Report Prepared by a group of European experts, Technical Assistance Mission No. 50 (Paris: Organization for European Economic Co-operation, 1952), pp. 44-45.

CHAPTER IV

WHAT TO EXPECT OF BUDGETARY ADMINISTRATION

Merits of Budgetary Control.--Sometimes there is an erroneous conception that the budget is a rigid, inelastic plan involving much red tape. Where a system of budgetary control is properly installed and operated, such an idea is without foundation.

Mr. A. G. Avant and A. H. Franking in recommending a budget plan, commented as follows:

> Companies who let objections stand in the way of a sound budget program are the ones which would derive the greatest benefits from one. The more complex and unpredictable the enterprise, the more imperative the need for a formal budget preceded by careful and considered planning. The cost of a budget installation sensibly made and geared to the company's operations is repaid many times in improved management and increased profits.[1]

The chief merits of the budget idea are found in its use as a device for educating personnel, for establishing policies, for placing authority in terms of organization, for supervising, for measuring and judging efficiently, and for coordinating the numerous activities of the concern.

Educational Uses.--One of the chief weaknesses of the present day executive is his inability to train and direct assistants. Many executives spend too much time looking after routine matters which could better be executed by a person of lower rank and salary. If this valuable time were conserved, it could well be used in devising policies and procedures for

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[1]A. G. Avant and A. H. Franking, "What Can a Budget Program Accomplish?," American Business, XXVI (March 1956), p. 23.

improving operating efficiency. Some people who realize the situation do not know how to train assistants to assume responsibility. Budgetary control is a partial answer to the problem. It affords a systematic means by which the senior executive may tactfully examine and make recommendations for improving a suggested plan of the junior before expensive operations have been set in motion.

Policies Accurately Stated.--How can an executive better state policies and plans for execution than by carefully estimating revenue and expenses by departments and sources of the organization? The budget affords a definite and systematic means and a scientific approach to the question. Many organizations fail because too much time is given to execution and too little to planning. Day to day operations without well-laid plans result in the dissipation of personnel and material resources. It is not sufficient merely to plan. The method of planning should be definite and specific. The old rule-of-thumb idea is dangerous, for it fails to recognize basic principles of organization and administration. Planning under budgetary control is much more scientific, because it takes into consideration the operations of several past periods, provides a systematic means of dividing a problem into its parts, and sets a goal in the light of present conditions with past operations as a properly directing factor.

Authority in Terms of Organization.--It is a generally accepted theory of organization that responsibility and authority should be co-equal; likewise, it is equally as important that the responsibility should be delegated in a definite and systematic way. In this modern day of specialization no one person can effectively direct an unlimited number of activities. The budget is a valuable device for delegating authority to various executives.

No better way of delegating responsibility and authority has been found than to extend it in terms of the planned operation of purchasing, manufacturing, selling, financing, and the controller. If the organization is properly designed, then the budget should clearly show what financial authority is extended to every executive in terms of operating units.

Basis for Supervising and Measuring Efficiently.--Chief among the merits of the budget is its quality as a supervising device. It is not enough to extend authority. Each executive who has been placed in a position of authority must render a regular accounting of his operations. The executive interested in effective supervision will find the budget particularly helpful in performing this task. If it has been carefully planned, it will provide information for setting forth the general plan in terms of expected sources of revenue, the expenses of raising this revenue by sources and departments, and specific needs for supplies, personnel and equipment. Second, it will furnish a means for providing periodical information in terms of the above classifications of accounts. The supervising executive, of whatever rank, can see at a glance from his report what objectives were set, how far above or below the objective the actual figures have attained, what the accumulative results are to date, and how this period's operations compare with operations for the last period. The information thus provided will serve as a warning that either planning or direction or both has been either profitably or unprofitably performed. Fortunately, supervision under a budget plan of procedure can be changed in time to avoid expensive results.

It is not sufficient that reports merely provide information. The information provided must be in such form and with such promptness that results of individuals, departments, methods and procedure can be promptly

evaluated and remedies taken to rectify any unprofitable condition. In discussing this Mr. Mason Smith writes, "A good report may be defined as the communication in usable form to a responsible party of timely factual data for a specific purpose."[2] The budget is an effective tool for measuring efficiency.

Coordination: A Major Task.--Most textbooks written on business organization and management emphasize the importance of the factor of coordination. Oliver Shelton in discussing coordination stresses it as being the major task of the chief executive. He says, "Coordination should be the sole concern of the chief executive, such coordination being continued lower down the organization."[3]

The Winston Dictionary for 1946 defines coordination as being "the act or state of working together or functioning in harmony." Coordination may further be defined as the factor in organization and management which takes into consideration the close relationship which exists between the activities of all departments of a business and which seeks to bring about proper balance between these several departments so that the organization may operate to the highest degree of efficiency.

If coordination is lacking between production and sales in an industrial concern, there will usually be a shortage of merchandise sold in some lines and an over-production in others; and idleness of some plant equipment and an over-working of other equipment; a purchasing of too much of some raw materials and too little of others. Mr. Thomas M. McDade,

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[2]Mason Smith, "Internal Reports," Corporate Treasurer's and Controller's Handbook, ed. by Lillian Doris (New York: Prentice Hall, 1951), p. 797.

[3]Oliver Shelton, The Philosophy of Business Management (New York: Sir Isaac Pitman and Sons, 1940), p. 143.

controller of General Foods Corporation, in discussing the budget said, "More than any one thing budgeting means to coordinate all the activities of a business."[4]

Mr. J. O. McKinsey recommends that the budget committee act as a coordinating and advisory board. He says,

> The budget committee, composed as it is of the heads of different departments, affords an opportunity for these executives to discuss their mutual problems. Each can secure the reaction of all others, can obtain both their criticism and advice. Moreover, the executives learn to know each other, and to understand each other's point of view. This promotes coordination and cooperation, which are among the first essentials of effective administration.[5]

Limitations of Budgetary Control.--It is advisable that one realize the limitations of a budget plan as well as its merits. Mr. J. O. McKinsey mentions four such limitations as follows:

(1). The budgetary program is based on estimates.
(2). Budgetary plans will not execute themselves.
(3). Budgetary control cannot take the place of administration.
(4). Budgetary control cannot be perfected immediately.[6]

The apparent or real failure of the budget may be due to a multiple number of causes. Six common causes are,

1. Failure to seel the budget idea to the executives.
2. Improper organization set up for budgetary control.
3. Organization activities have been improperly arranged for administration.
4. Accounting and reporting system is poorly designed and executed.
5. Lack of definite authority for enforcing.
6. Too much expected of plan within a short period of time.

Failure to Sell Budget Idea.--Human nature has not changed greatly with the passage of time. There has always been resistance to changes and

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[4]Thomas M. McDade, An address before the Navy Graduate Comptrollership Students at George Washington University, March 29, 1956.

[5]McKinsey, Managerial Accounting (Chicago: University of Chicago Press, 1932), p. 112.

[6]Ibid., p. 424.

changes have not been accepted readily. Rather, it has resented changes, especially where the individuals affected have not been consulted and conditioned and their approval solicited in advance. If budgetary control is to succeed to the highest degree, a favorable psychological attitude must be developed. This can be accomplished through conferences and participation by those who are to effect the new plans. Unless executives in charge can be influenced in favor of the new plan, the budget will produce apathy and only limited success.

Improper Budget Organization.--In todays modern business there is no place in budgetary planning for an autocratic or paternalistic attitude on the part of individuals or a committee. However, it is essential to have an individual or committee in charge who will have authority to make decisions concerning (1) the length of the budget period; (2) the form in which estimates shall be made; (3) the time of year estimates shall be prepared; (4) the revision of estimates; (5) approval and coordination of estimates in a master plan; and (6) enforcement of estimates.

There is no one form of budget organization which will satisfy all types of businesses, for consideration in each case must be given to the nature and size of the organization, personalities, training and experience of personnel and the attitude of budgetary officials. Nevertheless, one is safe in saying that budgetary control should be centralized in order to effect economy of operation, standardize forms for preparation and reports, and to unify and coordinate planning as a whole.

Improper Grouping of Activities in Departments.--Since the budget is a statement of plans and a tool for control of executives it is essential that estimates and reports be prepared in terms of the organization of departments.

Thus, any illogical arrangement in organization necessarily means an illogical arrangement in budget estimates and reports.

If the organization is set up under a functional plan, then activities should be grouped so that emphasis is given problems which require a similar type of administrative ability. Sales activities require an entirely different type of thinking to controller activities.

Improper Accounting and Reporting System.--Any budget system is doomed to failure unless a well designed accounting and reporting system is incorporated within it. Budgets are nothing more nor less than a statement of the future accounts which the controller, in exercising his function, will analyze and criticize and then submit reports to the other executives.

Accounting as a tool for management should always provide a well ordered system which will lead itself to a clear statement of policies. An adequate accounting system is an absolute prerequisite for budgetary control. A system of accounting which does not accurately record transactions according to department needs provides unreliable information on which to base budget estimates and for comparative budget reports.

Mr. H. A. Fountain, Treasurer of the Ohio Public Service Company, states that,

> A requisite for successful budgeting is that the organization be vitalized by arranging accounts and accounting methods so that each supervisory employee may completely account to himself and his supervisors as to the discharge of his responsibilities.[7]

Lack of Definite Authority for Enforcement.--If a budget system is to succeed there must be definite authority for enforcing it. It is not enough to set up an adequate system and prepare complete and well-ordered

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[7]H. A. Fountain, "Requisite For Successful Budgeting," Annual Convention Series, No. 51 (New York: American Management Association, 1926), p. 75.

statements at regular intervals. Mr. J. H. MacDonald said, "It would seem that the matter of the enforcement of the budget is one of the most, if not the most, important part of the budget plan."[8]

There must be someone with authority who can approve variation from the appropriated amount. Too, the person in charge of enforcing estimates should be competent to make constructive suggestions for revising the budget to meet existing conditions. There is a lack of uniformity in business organizations concerning the person designated to enforce the budget. The enforcing officer may be president, assistant to the president, controller, accountant, or a person designated as the budget director. What is important, however, is that enforcing officers at various levels in the organization must be designated with the authority to enforce compliance with predetermined budget estimates.

Too Much Expected of the Budget.--One may change from a non-believer in the budget to an enthusiast who expects too much of it. The budget is not a mechanical device which is thermostatically regulated once it is set in motion. As Mr. McKinsey expressed it,

> The budget is not a panacea for all ills; it will not solve all problems by itself. Rather, it is an administrative device that is no better than the organization which carries it out.[9]

A budget plan will not accomplish fully what the concern desires without intelligent management, good organization and sound policies. Its opportunity to succeed depends upon an adequate accounting and reporting system, a group to work out its administration, and an individual with authority to

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[8]J. H. MacDonald, "Summary," Annual Convention Series, No. 51, (New York: American Management Association, 1951), p. 75.

[9]J. O McKinsey, "Enforcement of the Budget," Annual Convention Series, No. 51 (New York: American Management Association, 1926), p. 60.

exercise control over its operations.

It is almost impossible to design an organization, install a new accounting system, and institute a new budget plan, all in a brief period of time that will operate smoothly. The budget estimates cannot be prepared to the best advantage until an accounting system operates to report what has taken place during prior periods. Until uniform comparative information has been accumulated, there is no internal standard by which to offer criticism of operating results. No business will improve its operations completely through budgetary administration, but all of the business concerns which give budgetary control a fair trial will undoubtedly facilitate intelligent administration and management.

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